

GOVERNOR'S CONSUMER ENERGY PROTECTION TASK FORCE

Minutes of the Meeting January 9, 2004 Room 172, State Capitol Building Helena, Montana

ROLL CALL: The January 9, 2004, meeting of the Governor's Consumer Energy Protection Task Force was called to order by Chairman John Hines at 10:10 a.m., in Room 172, State Capitol Building, Helena, Montana. Members present were John Hines, Chairman, Commissioner Rob Rowe, Representative Alan Olson, Haley Beaudry, Chuck Swysgood, Dave Wheelihan, Bill Drummond, Tom Power, and Mike Uda. Mr. John Bushnell staffed the meeting.

Welcome and Introduction

Chairman John Hines began the meeting by noting Mr. Dave Wheelihan no longer has a potential conflict of interest and will be participating on the Task Force. Chairman Hines recognized all Task Force members are on the Task Force because of their expertise in energy issues. Therefore, all members could be subject to potential conflicts with specific topics. Chairman Hines asked to be notified of any topics where a member believes he may have a conflict and then asked that they refrain from voting on that particular issue.

Report of the Energy Code Subcommittee

Chairman Hines explained this subcommittee is working on four key areas, which include legislative fixes, enforcement, development of energy measures to be included in a code, and the process of adopting the code through the Department of Labor (DOL).

Mr. John Bushnell reported the subcommittee met on January 5, 2004, along with representatives of DOL and the Department of Environmental Quality (DEQ) and Consumer Counsel. The old Energy Code was adopted in 1993 and was modified in 1995. Mr. Tom Power clarified it is the residential part of the code which needs to be updated. Mr. Bushnell explained SB 340 was passed in 1993, and it contained an intent section which was interpreted by DOL in a manner which makes them hesitant to move forward with a code adoption process. Mr. Todd Everts performed a legal analysis at the request of Representative Alan Olson, and determined DOL is not prohibited from adopting a new Energy Code, as long as it conforms with all other parts of the law. In addition, DOL was hesitant to adopt a process prior to a decision from the Energy and Telecommunication Interim Committee. Mr. Bushnell understood the Task Force will be the working group for the Energy Code portion of the study envisioned in SJR 13. Therefore, Mr. Bushnell believes DOL will be willing to go forward, as long as the Task Force finds that proceeding will not violate the intent section of SB 340.

Chairman Hines believed the issue was not that DOL felt prohibited from moving forward; but rather, it is looking for a universal acclamation that it is all right to move forward.

Mr. Tom Power felt part of the problem is the Legislature has made it clear that it is unhappy when state agencies appear to be in conflict with statements of intent. DOL is looking to be exonerated from any charge that they are ignoring the advice of the Legislature.

Representative Olson added the 2003 Legislature adopted a Resolution setting direction to look at updating the Energy Codes, and Mr. Chuck Swysgood noted that Statements of Intent have no force of law.

Mr. Todd Everts informed the Task Force that the Statement of Intent suggested DOL follow recommendations made by the Environmental Quality Council (EQC) that the Energy Code provisions and State Building Code be reviewed, and the Code itself should not be reviewed until there was another process undertaken by EQC in a working group energy policy process in conjunction with the Public Service Commission (PSC) and DEQ. Mr. Everts agreed the Statement of Intent has no force of law and there is nothing prohibiting DOL from proceeding. Mr. Swysgood noted EQC has had ten years to act.

Chairman Hines suggested DOL should be moved forward in a proactive manner. Representative Olson informed the Task Force this item is on the March agenda for the Energy and Telecommunications Interim Committee. In addition, the Interim Committee has already agreed the Task Force should become the working group on Building Codes. Therefore, if the Task Force were to make a recommendation, the Interim Committee could take action at its March meeting.

Mr. Power understood the Task Force could encourage DOL, or request the Interim Committee to encourage DOL, to get started on beginning the public process of drafting new Energy Codes, and the adoption of particular standards will have its own process. The goal of Task Force is to get that process started as quickly as possible.

Chairman Hines felt the Task Force could send a letter to DOL and the Interim Committee requesting that this move forward and include in the letter rationale why the Task Force believes it would be cost-effective to update the Energy Code.

Commissioner Rob Rowe moved the Task Force issue a recommendation to the Governor, DOL, and the Interim Committee to (1) clarify there is no legal barrier to Code modification; (2) request the Governor and DOL to begin the process of updating the Code; and (3) request the Interim Committee to designate the Task Force as the entity to do the technical work in this area. Part of that technical work will include summarizing the material the Task Force reviewed over the past several months.

Representative Olson corrected the motion, noting the Interim Committee has already authorized the Task Force as the working group. Chairman Hines suggested the motion be amended to reflect the Task Force has accepted the responsibility designated to it by the Interim Committee.

The motion carried unanimously.

Mr. Bushnell explained the subcommittee continues to work on adoption of cost-effective building measures for the new Energy Code. In addition, the subcommittee felt the misunderstanding about the intent section of SB 340 should be addressed, and work on enforcement and consumer protection continues as well.

Chairman Hines suggested the subcommittee focus on developing different paradigms of actual cost-effective measures to be floated out to the various interest groups.

Northwestern Bankruptcy - Panel Discussion

Chairman Hines provided an introduction and explained one of the Governor's charges was to evaluate issues relating to consumer protection for ratepayers. One key role of the Task Force will be to identify risks that need to be addressed by the participants in the bankruptcy proceeding. In trying to identify the risks, it has been helpful to focus on what type of macro goals they would like to see in the outcome, and then look for the associated problems that may inhibit those goals from being achieved. Chairman Hines suggested two goals emerging from the bankruptcy should be (1) the emergence of a utility structure with long-term financial viability and a utility that is of investment grade; and (2) ratepayers should be no worse off and, hopefully, better off. This would include the ratepayers not being burdened with any costs associated with the bankruptcy. Chairman Hines acknowledged there may be other goals or subsets of these goals, but he believed the two goals he presented are critical from the consumers' perspective. Chairman Hines thought there may be reason for concern for not being able to achieve these goals since he recently received a study showing the success of bankruptcies throughout the country. This report showed approximately 55 percent of large bankruptcy proceedings are taking place in Delaware, which has a between a two and ten times lower success factor. Chairman Hines submitted Montana needs to be proactive in its endeavor by identifying core issues that could affect the goals, and have state agencies work to get the core issues addressed in the bankruptcy proceeding. At a minimum, these views need to be publically known to the creditors, the bankruptcy court, and Northwestern Energy (NWE). Chairman Hines expects the state offices and agencies will use the core issues, as well as other factors, as part of an overall screen or litmus test of the bankruptcy plan. Chairman Hines felt strongly without these cores issues, attainment of the overall goals will be difficult to achieve and that this is unacceptable to state policymakers and ratepayers.

Chairman Hines explained the PSC requested \$1.2 million in supplemental funds to protect Montana ratepayers' interests in the bankruptcy proceeding. The money will be spent on hiring attorneys and a financial consultant. Other state representation includes the Attorney General's Office and the Consumer Counsel. A signed Memorandum of Agreement (MOU) will require sharing information from the financial consultant among the PSC, Attorney General's Office, and Consumer Counsel. Therefore, Chairman Hines invited representatives from each of these entities, as well as a representative of NWE, to speak to the Task Force on the status of the NWE bankruptcy.

- **Jim Screnar, Bankruptcy Unit, Department of Justice**

Mr. Jim Screnar, Bankruptcy Unit, Montana Department of Justice, addressed the Task Force and stated NWE's bankruptcy is utilizing a lot of the state's resources since the Attorney General's Office and the Governor's Office are now involved. The PSC and Consumer Counsel have separate counsel and are representing the interests of consumers. Weekly meeting will be held among all the agencies involved since they all represent the State of Montana.

Mr. Screnar stated NWE will present a plan in February which will be accompanied by a disclosure statement. This disclosure statement will set the basis for what NWE believes the plan should be, how they attend to accomplish the plan, and an explanation of why they got into trouble. The plan is critical and the state needs to actively participate through its economist. After the plan is filed with the court for approval, competing plans can also be filed. Mr. Screnar explained the creditors' committee is very powerful, and its purpose is to maximize what the creditors will receive out of the bankruptcy. The State of Montana has a qualified facility contract with NWE for the Toston Dam, which is funded by revenues with bonds, and the bonds are paid back through the revenues received on the contract. This is an executory contract, which means in bankruptcy, NWE, as the Debtor, could disaffirm the contract resulting in litigation. The state uses the revenue stream from this contract for repair of the Toston Dam and other dams. While this facility does not represent a lot of power to NWE, it is significant to the state. NWE is continuing to make payments to the state as agreed upon in the petition for use of the facility. The amount due prior to the filing of the petition has not been paid, and that amount will allegedly be part of the bankruptcy plan.

Milltown Dam is another very complicated issue. The Governor's Office and the Attorney General's Office have said the dam should be removed and the stream restored, but the question is who will pay for it. The issue of whether NWE or Atlantic Richfield Company (ARCO) is responsible remains to be decided. The State of Montana must file its claims by March 15, 2004, so it must be decided how the state intends to proceed in filing a claim concerning the Milltown Dam in bankruptcy court. A claim cannot be paid in bankruptcy until it is non-contingent and unliquidated. Liability must be determined, as well as an amount. The question is which court

will make that determination. The State of Montana hopes the liability of NWE and the Blackfoot LLC, and how those play together, will be determined and a stipulated claim is filed with the bankruptcy court. In addition, the state is concerned about the never-ending problem of getting taxes paid. To date, NWE has paid its taxes, and its payments are being monitored by the Montana Department of Revenue. NWE has entered into a stipulated agreement with ARCO as to the responsibility between NWE and ARCO over Milltown Dam. The stipulated agreement is now before the court on a motion by NWE for approval. The State of Montana, as well as the Environmental Protection Agency (EPA), have both filed objections to the approval of that agreement. The hearing on these objections was set for January 14, but Mr. Screnar understands the hearing has been continued to February 17, but noted the January 14 hearing is still on the docket. The State of Montana is prepared to attend the January 14 hearing and support its objection unless it hears otherwise.

Mr. Screnar is hopeful a plan will come out of the bankruptcy court system that is beneficial to everyone and results in a viable A-rated utility. Mr. Screnar felt bankruptcy is a system of procedure, not substance. The State intends to stay involved in the bankruptcy to make sure the procedure is properly followed before the plan is confirmed. Once the plan is confirmed, the bankruptcy is complete.

Mr. Haley Beaudry asked if the State of Montana had been formally designated as a creditor. Mr. Screnar clarified Montana is a creditor, but has not yet filed its claims. Mr. Beaudry asked if his understanding was correct that a claim cannot be filed until there is a defined liability. Mr. Screnar stated that was not the case and an estimated claim can be filed. Before the plan can be finally confirmed, the claim has to be liquidated and the issue of liability and amount have to be finally determined. The forum to liquidate the claim could be the bankruptcy court in Delaware. Mr. Screnar stated further there could be two types of claims since there is a liability for the environmental issue until date of filing, and a continuing responsibility because of the continuing environmental damage the dam could cause post-petition. The hope of EPA and the state is to clear up the matter by having the dam removed and the stream restored. Apparently, there is confusion about whether the property is still in the corporation or the LLC. All of this leads to the complex nature of the Milltown Dam issue.

- **Bob Rowe, Montana Public Service Commission**

Commissioner Rowe would like to see a utility emerge that is customer focused, Montana focused, and utility focused. The key theme to get there is sustained cooperation between the Governor's Office, the PSC, the Consumer Counsel, and the Attorney General's Office. While there are risks being in the Delaware bankruptcy court, Commissioner Rowe feels the judge on the case seems to be very engaged and constructive. Many of the failed reorganizations involved plans that were prepackaged or uncontested. Commissioner Rowe was confident having all the

agencies involved will help ensure a better result. There is an incentive in bankruptcy going through the creditors' committee to get something out the door quickly that has good curb value, but may not be sustainable. Here, sustainability is the focus of all the parties involved. The PSC has been working for a number of months in anticipation of this bankruptcy, as has the Governor. The PSC, Governor's Office, Attorney General's Office, and Consumer Counsel have met and decided there are two issues: (1) quasi-creditor claims; and (2) the broader consumer interests and interest of the State of Montana in a viable utility. A Memorandum of Understanding (MOU) was entered into which designated liaisons and put together an MOU working group that meets weekly. This working group went back and re-interviewed a number of financial experts and ultimately selected Morgan, Joseph & Co., Inc., as the financial expert and negotiated a contract and entered into a Scope of Work Agreement. The PSC entered into a contract with an outside bankruptcy firm which has been very helpful. Now, they are looking at goals and strategies in the bankruptcy and what it is they want to achieve.

The scope of work agreed upon by all the agencies can be divided into three phases: (1) due diligence and understanding the conditions on the ground in NWE currently; (2) review of business plan and plan of reorganization; and (3) focusing on a plan of reorganization, consummation, and implementation.

In speaking to objectives, Commissioner Rowe summarized the objectives for the utility as being customer-focused, Montana-focused, and utility-focused. Commissioner Rowe broke these goals into three categories consisting of financial goals with a utility that are sustainable over the long term, and that there be no rate increases to customers that are attributable to the bankruptcy. The PSC has sought to preserve its authority to review various expenses to ensure they are appropriate for recovery from customers. NWE has not had a revenue requirements case since it took over and inherited the existing revenue requirements.

(Tape 1; Side B)

Commissioner Rowe cited one goal as being that service not deteriorate. Another area of concern is corporate governance, and the outcome should be a utility-focused enterprise, and Commissioner Rowe felt the Task Force's discussion of ring-fencing will be very helpful. Commissioner Rowe is concerned about strong internal financial controls and would like to see ring-fencing that would be enforceable by the PSC as one outcome. NWE has taken the position that the PSC does not have that authority under current state law. Commissioner Rowe is also concerned about adequate expertise and independence on the NWE board and adequate staffing. Commissioner Rowe stated that coming into the bankruptcy, he was concerned about adequate natural gas and electricity for the core default supply customers in the period before the bankruptcy. A successful meeting was held with all of the gas utilities a couple of weeks ago which focused on procurement practices, and they will be following up with NWE. NWE had

intended to, and was expected to, file its electric default supply plan in December, but did not. There was an indication in NWE's letter to the PSC that it simply was not able to sufficiently staff that undertaking. Commissioner Rowe felt this was a result of NWE having to focus on the bankruptcy. NWE is now preparing an information filing with the PSC depicting the status of the work on default supply. Commissioner Rowe reiterated that good cooperation between the agencies has been crucial, and the focus needs to be on having a long-term viable utility.

Under due diligence, Chairman Hines requested more detail from Commissioner Rowe, and specifically, whether they were looking at the level of TND maintenance over the past few years and whether it is sufficient and, if not, the type of money that would be required to bring it to a level of reliability.

Commissioner Rowe stated they have looked at this recently, and NWE submitted a report to the PSC that reported on all the basis engineering measurements and budgeting levels. The PSC has requested not just budget amounts, but actual expenditures and, in particular, on the distribution system.

Chairman Hines recalled reading where the SEC had initiated a formal investigation of its blue dot and wondered if that was also part of the due diligence as far as evaluating the amount of financial risk involved. Chairman Hines wondered whether any potential penalties by the SEC would be dischargeable in the bankruptcy proceeding. Commissioner Rowe replied an important part of the work with the financial consultant is examining inner-company transfers and the transactions of the subsidiaries. They are monitoring the investigations outside Montana, but not actively participating.

Chairman Hines also has a concern about the sale of the portion of the transmission system and whether the revenues would flow back to the utility or to ratepayers, and he wondered if that was also part of the due diligence. Commissioner Rowe agreed that issue is part of due diligence, and replied they have been monitoring the litigation and have not intervened.

Mr. Beaudry asked if there was a list of due diligence items being investigated. Commissioner Rowe replied there is a Scope of Work appended to the contract. Mr. Beaudry wondered if the assignment included attaching a dollar figure to each item on the list. Commissioner Rowe replied many of the items are quantifiable.

In response to Chairman Hines, Commissioner Rowe assumed the contract with the financial advisor with attached Scope of Work, was available publicly. Mr. Screnar agreed. As to work product, it is Mr. Screnar's philosophy the public should be aware of everything, but once attorney work product becomes an issue in litigation cases, there may be areas where their work product is confidential.

Commissioner Rowe provided the Task Force with a copy of the contract with Morgan Joseph & Co., Inc. as Exhibit 1.

- **Bob Nelson, Consumer Counsel**

Mr. Bob Nelson, Consumer Counsel, spoke about the status of the bankruptcy, as well as the goals and objectives of the Consumer Counsel. Mr. Nelson testified there are monthly omnibus hearings. Mr. Nelson gave a list of the highlights from the Consumer Counsel's perspective. The post-petition financing has been arranged, pre-petition tax payments have been authorized, compliance with pre-petition forward contracts and authority to enter into new-post petition forward contracts in the ordinary course of business have been approved resulting in security of supply. In addition there has been a segregation of the public purpose funds. An order enforcing the automatic stay provisions of the bankruptcy court was issued and has now been modified to allow certain key proceedings at the PSC, such as the financial investigation, to proceed. In addition, work has been done on the sale of subsidiaries. The Consumer Counsel and PSC filed comments and limited objections of the latter three matters.

An omnibus hearing is scheduled for next week and items on the docket include matters regarding litigation against non-debtor subsidiaries and relates to how proceeds from the sales can be brought back up to the parent company. Also on the agenda is a motion for approval of the Clark Fork Blackfoot settlement with ARCO, approval of intercompany transfers relating to payments to maintain the MFM project, and the Milltown Dam. Also, there is a motion pending for a two-month extension of the exclusivity period which originally ran on January 15. Also, there is a motion for bonus and incentive payments, and the PSC has filed its objection, and the Consumer Counsel will be filing a limited objection requesting any order issued by the court maintain the PSC's jurisdiction to treat those costs, for rate purposes in the future, to protect consumers from payment of those kinds of costs.

The plan of reorganization will be the heart of the bankruptcy proceeding. There have been weekly meetings between the four agencies in Montana to formulate goals and objectives. Those goals and objectives include (1) a company focused on utility service; (2) protection of consumers from costs related to the failure of the non-utility operations; (3) ongoing utility service to be at just and reasonable rates; (4) a utility that provides adequate, reliable, and safe service; and (5) future protections to avoid unreasonable rates and poor service and a repeat of the current situation. The financial investigation is now back on track; and there has been a revised request for information and revised objectives issued. Some of the issues in the investigation will be pertinent to the bankruptcy and future consumer protections. Development of cost-allocation principles for the utility and principles regarding future financing requirements could all be categorized as part of the ring-fencing discussion and will all be important to future consumer protections.

Mr. Swysgood requested a copy of Mr. Nelson's bulleted list.

Regarding the jurisdictional issue, Chairman Hines felt some of the changes they are requesting through a negotiated process are not going through the state law process, and they are trying to negotiate a process such as ring-fencing. Absent a rate increase, Chairman Hines wonders how that can be accomplished and would like to know if they are wanting to accomplish these events absent statutory changes. Mr. Nelson noted there are a couple of statutory changes they would like to look at relating to PSC authority over mergers and acquisitions. Mr. Nelson believes there is current authority in state statutes to do everything they have requested the PSC to do in the financial investigation, but it may be preferable to have some of those areas clarified. Mr. Nelson believes there will be an opportunity for the PSC, and the other parties participating in the financial investigation, to give a clear indication to the utility as to what their expectations are and what the future requirements of the utility will be, so a plan of reorganization can be based on those regulatory expectations and requirements and will thereby increase the likelihood that a reorganization will be successful.

Chairman Hines followed up by stating if they come out with a reorganization plan in another month, he did not believe they would be on parallel tracks. Mr. Nelson expected continuing discussions to occur, and there will be a period of time where modifications and tweaks will be made to that plan based upon the input they get after people review the plan.

Commissioner Rowe stated NWE has made the statement that mandatory review of the Bankruptcy Code is triggered by a rate increase. More broadly and more practically, NWE's experts and attorneys are deeply engaged with the state parties in negotiations. NWE does appreciate the key role of the PSC and other parties as the gatekeeper and most essential parties to its ongoing liability. Whether there is a rate increase requested as part of the reorganization, the ability of the MOU agencies to effect the reorganization is very strong. Commissioner Rowe testified that NWE has heard the message that none of the MOU participants support the idea of imposing bankruptcy-related costs, or affiliate-related costs, on customers.

In addressing the second question of the relationship between the bankruptcy plan of reorganization and the investigation of various remedies, on December 30, the PSC issued an order refreshing the scope of the investigation based on the bankruptcy proceedings. Commissioner Rowe's view is that both actions are very well coordinated and felt there could be some real value to having the investigation docket opened at the time a plan of reorganization is being informally considered by the bankruptcy court, so parts of the agreement could be filed in the investigation and used as an enforcement mechanism, particularly for some of the ring-fencing strategies. Commissioner Rowe depicted this as a "belt and suspenders approach" for the underlying need to clarify the statutory authority and the potential ability to implement and enforce through PSC proceedings and the bankruptcy reorganization.

Mr. Nelson added that while the absence of a rate request in order to fund the reorganization may not trigger the need for PSC review as part of the bankruptcy process, the Bankruptcy Code does not preclude the PSC from engaging in its normal regulatory process of exercising its authority to review rates.

Mr. Bill Drummond asked if NWE's creditors agree on a bankruptcy plan, what the likelihood is that the plan will be accepted by the bankruptcy judge regardless of the views of other parties. Mr. Nelson agreed the judge could accept the plan regardless of what everyone else thinks. Mr. Srenar informed Mr. Drummond and the Task Force there are 12 confirmation requirements in the Bankruptcy Code that must be met. One of the requirements is voting, and when all the creditors are behind a plan, it is very difficult for that plan to not be the one accepted. In a utility bankruptcy, the state still has its regulatory powers, and the plan may not meet the regulatory rate making powers of the state. Therefore, the state is a big player and cannot be ignored because of its rate making power. Mr. Nelson added the PSC has a particularly important role to play because, to the extent that the plan is based upon some assumptions about revenues that do not comport with regulatory realities, it is difficult to find a feasible plan. Commissioner Rowe added this is part of the reason it was important to get in and get active early on.

Mr. Drummond then asked if NWE and the creditors agree on a plan, and the judge affirms the plan, could the judge force rates in Montana sufficient to fund the plan regardless of the position of the PSC or the state. Commissioner Rowe replied this is a highly disputed point. The PSC's position is that it retains authority over rates and, to the extent a rate increase is required by part of the plan, there is an express role for the PSC provided in the Bankruptcy Code. Mr. Nelson was confident the PSC would retain its authority to set rates. Any dispute would be adjudicated in the federal district court and then to the federal appeals court, which in this case would be the Third Circuit Court of Appeals. Mr. Srenar added the interplay of the bankruptcy court system with state regulatory agencies is a very interesting issue and could result in an interesting battle since the major concern is to protect consumers.

Commissioner Rowe thought the degree to which the bankruptcy court defers to state authority will depend, to some extent, on the attributes of state regulation under state law. NWE has made somewhat inconsistent statements about the degree to which state authority might be preempted. The PSC will assert it does retain authority.

Mr. Drummond is concerned that if the creditors and NWE cut a sweetheart deal for the creditors, it could result in huge rate increases for the State of Montana, and an inability to turn to the PSC for protection. Commissioner Rowe explained the worst possible case would be that the bankruptcy court would look at the specific authorities granted to the PSC and say the state has

effectively made the decision that it is not going to grant these particular authorities, so the bankruptcy court does not have to. Therefore, on a long-term basis, it is important to deal with things like ring-fencing.

Mr. Drummond's concern was that the creditor's motivation is not driven by the interests of the State of Montana.

Commissioner Tom Schneider addressed Mr. Drummond's concern by stating once the creditors' committee submits their plan to the court, it is a done deal. Mr. Schneider expected to see competing plans, including potential acquisitions. Commissioner Schneider added it was Mr. Drummond's concern that drove the Governor, PSC, and Consumer Counsel to participate aggressively with the creditors' committee and the debtor to mitigate conflicts.

Mr. Power stated one of the qualifications to that objective is to see no rate increases that are tied to the bankruptcy and, to the extent that there are rate increases that appear to be necessary, that are not tied to the bankruptcy but are tied to natural revenue requirements associated with operating a Montana utility, Mr. Power wondered how the PSC would deal with those rate increases. Mr. Power wondered how the bankruptcy court would make sure that reasonable costs associated with providing service to Montana customers are built into the plan.

Commissioner Rowe replied he is not opposed to a rate change to bring rates into alignment with underlying costs. There are indications that some costs of the utility operation may be lower than what they were as a result of changes and various budget items. There also could be concerns that investment in the infrastructure has not been adequate. NWE had been interested in a revenue requirements case because its rates were out of date by several years. Commissioner Rowe's sense is that NWE will now not want to see a revenue case this year, because one of its objectives in bankruptcy is a predictable stream of revenue. Therefore, the PSC is attempting to have its revenue requirement staff and Consumer Counsel work intensively with outside financial experts to make sure they understand how the PSC computes a revenue requirement. The PSC is attempting to get a common basis of analysis between the two processes.

Mr. Mike Uda stated it seems to him that certain representations were made to the PSC about financial commitments when NWE acquired the Montana Power Company (MPC). Mr. Uda thought some of those commitments may have, in some regard, contributed to NWE's ultimate bankruptcy. It seemed to Mr. Uda there may be a relationship between representations made at that time and their ultimate disposition in filing bankruptcy. Mr. Uda wondered how these things could be disaggregated and how you could break apart what contributed to the bankruptcy from the actual costs.

Commissioner Rowe agreed it can be difficult to disaggregate all the pieces, which is why ring-fencing should be in place. Commissioner Rowe depicted this as the ultimate Hobson's choice. MPC did not have ring-fencing in place and was pulled under water. There were some benefits with the transfer, and NWE wanted to be in the utility business while MPC did not. The PSC tried to determine whether NWE had sufficient resources to take on the obligations associated with the transfer, and to the degree there were specific representations made, Commissioner Rowe thought those were things the PSC would need to look at.

(Tape 2; Side A)

Mr. Nelson stated there can be multiple causes to certain events, and it is sometimes difficult to sort out who is responsible and who is going to bear the burden. He suspects this will present the PSC with fact issues to be carefully sorted out. Mr. Uda clarified the thrust of his question as whether there is going to be a rate increase associated with the bankruptcy will depend on how they define what is associated with the bankruptcy. Mr. Uda made the assumption that a plan emerges that is acceptable to the creditors, the bankruptcy court passes the plan, the PSC feels good about the plan, and NWE emerges from the bankruptcy, Mr. Uda wondered at what point the bankruptcy court would lose jurisdiction, and the PSC would assume jurisdiction over rate setting matters. Commissioner Rowe responded the primary jurisdiction of the bankruptcy court will cease as soon as a plan of reorganization is approved. The PSC does not lose its jurisdiction during the pendency of the bankruptcy.

Mr. Al Brogan informed the Task Force that as the plan is developed, it will have a confirmation and an effective date. Upon the execution of the plan is when the bankruptcy court will lose jurisdiction and that will be a date certain.

Mr. Screnar explained that what is happening in a lot of bankruptcy courts outside of Montana is there is a confirmed plan and then a time to determine claims. The time to determine claims can be anywhere from 60 to 90 days. It is only after that claims process is over that the court issues a final order, and its jurisdiction is over.

Mr. Beaudry told Commissioner Schneider that the gist of the whole solution has to do with what the creditors' committee accepts as plans. Commissioner Schneider stated there will be several competing plans. Mr. Beaudry wanted to know if the creditors' committee would look at all the plans and take the best plan. Mr. Beaudry noticed the word "customer" does not appear in bankruptcy law; rather, bankruptcy law only governs the relationship between the debtor and the creditors. The Task Force's concern, however, is the customer. Commissioner Schneider agreed it is a complicated process even just formulating the creditors' plan and the filing and suggested that is why the PSC is aggressively involved. The scope of the work is attempting to cover all eventualities, including potential sale or alternative offers by other reorganization plans. If

alternative plans are presented, they will be considered by the creditors' committee, as well as the court. Therefore, the court may have an array of different options available. The MOU was structured in anticipation of becoming involved in that process.

Mr. Beaudry had heard many of the people on the creditors' committee have been involved in other creditors' committees in bankruptcies. The general consensus is that if someone comes in with an offer of \$1 billion, and the second offer is \$1.1 billion, even though everyone in Montana will freeze, then \$1.1 billions is the offer the creditors' committee will take. Mr. Beaudry is concerned the creditors' committee and the judge may accept something that will not allow the company to survive.

Commissioner Schneider felt there would be huge write downs under any circumstances, and that is why the emerging company is going to need a viable entity under regulatory rate making standards that exist in Montana. Commissioner Schneider felt it would be up to the unsecured creditors, who will become the new stockholders. Mr. Beaudry added many of those unsecured creditors are also on the secured creditors side. Commissioner Schneider agreed there is overlap. Commissioner Rowe commented the fact that the state, PSC, and Consumer Counsel are active in the bankruptcy makes the danger less likely; however, the danger is still very real, so the parties need to remain fully engaged.

- **John Fitzpatrick, Northwestern Energy**

Mr. John Fitzpatrick, Northwestern Energy, commended the state for its participation in NWE's bankruptcy and felt it is a very worthwhile effort. Although NWE may not always agree with the state's position, the dialogue will be important in forging an acceptable bankruptcy plan.

When NWE went into bankruptcy last September, it set forth three broad goals. The first goal was to emerge from bankruptcy as a financially stable investment grade utility. This goal is shared with the Consumer Counsel, PSC, DOJ, and the citizens of Montana. Part of that effort included divesting the company of its non-utility businesses, and they have had more success in doing so since the bankruptcy was filed. The third goal is to bring NWE around to a financially stable investment grade utility was the need to significantly reduce its debt by approximately \$1 billion.

Mr. Fitzpatrick felt there have been a number of positive steps taken since the bankruptcy filing. One of the reasons NWE felt it needed to go into bankruptcy was the fact that its cash flow was very, very tight, and its ability to operate had been seriously compromised by the need to make prepayments for energy supplies. The return to normal credit terms with energy suppliers has been very helpful to NWE's cash flow and has assured energy supplies for Montana customers. In addition, NWE has brought its tax payments up to date and received approval from

the bankruptcy court, which will allow NWE to pay its taxes as they come due. When NWE went into bankruptcy, all the monies it was holding on behalf of customer, could not be released pending court approval. The bankruptcy court approved a motion to allow NWE to return to its normal practices for customer deposits and refunds.

NWE has been successful in identifying contractors and suppliers who are available to supply critical services to NWE to ensure continuation of service. The pre-petition trade debt owed to Main Street vendors in Montana, South Dakota, and Nebraska has been substantially reduced to \$4.2 million. In the plan, NWE anticipates paying off all of its creditors in full. Activities to continue the integration of the utility operations between the three states continues. The bankruptcy court approved NWE's ability to terminate its contract with Otter Tail in Minnesota, which was providing system monitoring services for the South Dakota utility, and that function has now been moved to both South Dakota and Butte. NWE continues to work on transferring accounts payable, printing functions, and a number of the engineering functions from South Dakota to Butte.

Mr. Fitzpatrick continued by stating there are a large number of issues NWE will be dealing with in the plan and highlighted three or four of these issues for the Task Force. There is an intensive effort to review all of NWE's contracts, leases, and permits. This activity must be completed as part of the overall plan to determine whether any of the contracts, leases, or permits should be rejected. This involves review of thousands and thousands of files. At this point, none of the contracts have been rejected, and it is expected the number of contracts that ultimately get rejected will be small. There is a very significant financial gap between the projected cost of the QF contracts over the next 25 years and the revenue they will generate. This item will be very important in terms of the overall financial stability of the plan. Also, it is very important to the state of Montana, particularly in terms of the Broadwater contract since it is backed by state bonds and the state credit is at risk, and that contract generates widely needed revenue for the maintenance of water projects in the state.

Plan development is continuing to take place between the company, its advisors, and the creditors' committee. Mr. Fitzpatrick clarified that there is an expectation that the plan will anticipate that somehow the debt of the corporation will be paid off by some sort of rate increase to be used to pay down the debt. Mr. Fitzpatrick disagreed stating the unsecured creditors will make an exchange for stock in NWE. This process is still being developed.

Mr. Fitzpatrick agreed with Mr. Srenar's presentation with respect to the Milltown dam. To date, Mr. Fitzpatrick feels consumers have not been adversely affected by the bankruptcy in Montana. There have not been any bankruptcy supply problems, and gas and electricity continue to flow. NWE is back to normal credit terms with its suppliers and the relationships are working well. Mr. Fitzpatrick brought the Task Force's attention to the fact that PPL, Montana, was the

first party to step up to the plate and return to normal credit terms. During this past severe weather, Mr. Fitzpatrick explained NWE experienced only the types of problems which are typical during severe cold weather and service levels continued to be good. Complaints filed with the PSC regarding NWE are down from what they were in 2002. There have not been any bankruptcy rate adjustments and there are none planned as part of the bankruptcy reorganization plan. Mr. Fitzpatrick anticipates a rate case will be held sometime post-bankruptcy since there are a number of things going on that have affected the company that need to be brought to the PSC's attention. Mr. Fitzpatrick presented NWE's rising pension costs and property taxes as examples.

Rep. Olson inquired how many employees NWE has in Montana. Mr. Fitzpatrick estimated 1,000 employees state wide with approximately 550 employees in Butte. Mr. Fitzpatrick responded there has not been any reductions in force as a result of the bankruptcy per se, but they have had some employees retire and others quit.

Regarding the QFs, Rep. Olson stated with the QFs NWE has to buy the power at one rate and sell it another rate. Mr. Fitzpatrick corrected Rep. Olson and explained the structure for the QF reimbursement consists of two pieces. A portion of the charge for a QF is included within NWE's supply rate, which is \$32.75 a megawatt hour. In addition, there is a surcharge on the bill, a CTCQF. Those two recapture a portion of the overall QF charge, but fall short, and the shortfall varies from year to year. Between now and 2030, it is expected the gap between the QFs' cost and what will be generated in revenues could run approximately \$400 million per year on a nominal basis. The QF contracts are part of the discussion in the bankruptcy, and NWE would like to negotiate some changes in these contracts. While there have been some very good discussions with the state, there have been no conclusions drawn, and none of the QF contracts have been rejected at this point. Under the structure of the agreement, there was a plan for how much money was going to be recovered, and MPC knew it would not be fully recovering these costs and NWE accepted that when it bought the company. In bankruptcy, new owners of the company may take a different view as to the advisability of continuing the contracts.

Mr. Uda submitted that when NWE bought MPC, as part of the stipulation approved by the PSC, NWE made a commitment not to recover a certain portion of what was computed at the time to be the out-of-market costs. In other words, the difference between what the contracts would be over time and what market rate would be, and they agreed not to recover that as part of the inducement to settle various different concerns between the parties about what NWE would bring to the table as part of the acquisition of MPC. That stipulation was approved by the PSC. Now that NWE is in bankruptcy, they are revisiting the issue about whether that gap is something they can continue to commit to in light of their current financial situation. Mr. Fitzpatrick agreed with Mr. Uda's analogy, adding if there was no pending bankruptcy, the contracts would not be challenged.

Chairman Hines asked if through the bankruptcy proceeding these contracts are not affirmed or lowered, given that there was another stipulation agreed to by the PSC about the proceeds going to the utility, if there is a reduction in payment, would the consumers see the benefit or would the money flow to the utility. Mr. Fitzpatrick believed the money would flow to the utility.

Commissioner Rowe held the opinion that NWE's position on modification of the CTCQF charge might have changed recently. Mr. Fitzpatrick agreed that could be the case and that he is not entirely up to speed on this issue.

Mr. Drummond inquired about NWE's position on jurisdiction of the PSC versus the bankruptcy judge with respect to rate changes resulting from the bankruptcy plan. Mr. Fitzpatrick was uncertain, but felt there was an expectation that if the bankruptcy results in additional rate changes, it would, in fact, go back to the PSC. If the rates do not change in the bankruptcy, then there will not be any PSC involvement.

- **Panel Discussion**

Chairman Hines reminded the Task Force the intent of this presentation was to explore some of the core issues the Task Force felt should be considered or emphasized. Chairman Hines thought it may be helpful to the Task Force's dialogue if they had a chance to review the scope of work contained in the contract prior to discussion.

Mr. Beaudry agreed he would like to review the scope of work and contract and thought that should be done as quickly as possible. Chairman Hines agreed, adding the Task Force could put forward a political perspective to the bankruptcy court, the creditors, and NWE on some of the issues that need to be addressed. The core issues are structure neutral and would apply regardless of the type of structure that emerges.

Commissioner Rowe commented the Task Force is a good public forum to get information out about the bankruptcy and related issues. Commissioner Rowe cautioned the Task Force to be careful about what kind of activity it wants. Commissioner Rowe thought the best outcome would be questions or comments that it would like to see the MOU group address since the MOU group has spent a lot of time coordinating who will be responsible for what and how they will communicate. Commissioner Rowe thought the best thing would be for the Task Force to communicate suggestions or refer requests for further information back to the MOU group rather than directly through the bankruptcy. Chairman Hines did not believe coming up with specific recommendations to solve the issues was the intent of the Task Force. However, ensuring these issues have some public knowledge associated with them is critical, especially since there is going to be a swap from debt to equity, and there needs to be assurance that equity is properly

evaluated. This means these issues have to be properly addressed. Chairman Hines stated he understood the concern about having mixed messages coming from the state, but did not believe that was the intent and suggested the message be sent directly to the PSC, Consumer Counsel, and the Attorney General's Office.

Mr. Uda requested specificity from Chairman Hines as to what he thinks the Task Force can accomplish. Chairman Hines cited Milltown Dam, due diligence, and smaller topics and core issues, would be appropriate for the Task Force to discuss. Chairman Hines' intent would be that Task Force's recommendations be forwarded to participants in the bankruptcy proceeding with the recommendation the issues be addressed to the extent that jurisdiction allows them to do so.

Commissioner Rowe restated his concern that if the Task Force is interested in highlighting issues in the bankruptcy, the communication should be with the MOU group rather than communicating directly with the bankruptcy court or others. Commissioner Rowe felt the Task Force's discussion of these issues is very valuable. Chairman Hines suggested reviewing the contract before making any decisions. Mr. Uda added the Task Force could act as a sounding board as well. Chairman Hines' understanding of the scope of work is that there are smaller issues that are important from a regulatory perspective, and there are larger issues that have a more critical role in achieving some of the major goals within the bankruptcy proceeding.

Task Force members will review the contract, and Mr. Bushnell will compile and circulate a list of issues to Task Force members for input as to what issues should receive emphasis or additional issues members would like to see addressed.

Mr. Swysgood asked the Task Force to keep in mind that the various parties may be considering different end results and that is why the parties all have different legal representation. There could be times when views and objectives differ. While we are in harmony on what is to be accomplished for the State of Montana and its citizens, there could be differing perspectives on the way to accomplish this goal.

(Tape 2; Side B)

Public Service Commission Structure

- **Janice A. Beecher, Ph.D.**

Janice A. Beecher, Ph.D., Director of Institute of Public Utilities, Michigan State University, addressed the Task Force on the structure of the Montana PSC, specifically an elected commission versus an appointed commission. In addition, Ms. Beecher addressed whether the current structure of the PSC could be made more efficient.

Ms. Beecher explained the Institute is in the business of training and educating regulators and working with them in supporting roles both nationally and internationally. The institute teaches the balancing act theory of regulation. Regulation substitutes for public ownership, which is more apparent in the water industry. Market failure can be contributed by the formation of monopolies and poor use of market power. Other contributing factors can include public health and environmental considerations. Regulation is considered an imperfect substitute for competition. Regulation, in some respects, should be superior to public ownership in terms of private investment, in particular in pricing efficiency. Regulation should also be institutionally superior to legislative rate making or judicial proceedings to resolve issues. If the state knows how to deliver power, telephone services, or water services better, cheaper, and faster than private companies, then they should do it. In reality, they combine imperfect competition with imperfect regulation.

Ms. Beecher just attended a national conference where the theme was "The Balancing Act." As part of the traditional theory of regulation, they talked a lot about the balancing act between ratepayers and investors. Regulation is supposed to provide the protection that captive customers need because they lack choices. On the other hand, investors need a certain amount of stability, fair treatment, and reasonable rate of return. In looking at the history of regulation, investors were very much a part of the creation of the structuring of the regulatory model. The job of the Institute is to teach people how to be in the middle between investors and ratepayers.

Ms. Beecher looks at the Mission Statements of regulatory commissions and how they perceive their roles. Safety and reliability of utility services remains very important. Competition and utility efficiency and agency efficiency are being seen more frequently, and only one commission mentioned incentives. Ms. Beecher presented the Mission Statement of Montana's PSC and depicted it as a classical statement of regulation. Montana's Mission Statement recognizes the changing environment and the balancing act. Ms. Beecher appreciated the fact that the Mission Statement recognizes the complexity. Florida took on a fairly assertive statement stating its role is to promote and facilitate the development of competitive markets, removing regulatory barriers, and eliminating involvement to the extent permitted by law. Therefore, commissions are working their way through transitions, and Ms. Beecher feels there will be a state of flux for the foreseeable future.

In balancing consumer and investor interests, Ms. Beecher addressed some of the other acts of balancing and regulation that are being seen today, including adequate investment and prudent investment to address infrastructure needs. This is becoming more challenging especially in restructured markets. How to get timely cost recovery without sacrificing oversight, and how to balance economic efficiency and social equity are also classic questions in regulation. Balancing market successes and failures and determining when a market failure is unacceptable are additional issues. Customer choice and the obligation to serve can also be tricky.

In Ms. Beecher's mind, regulation has always been about three things: Setting standards, holding utilities accountable through various means, and providing utilities with incentives for performance. Ms. Beecher believed these three things to be important in the past, present, and future. Rate base rate of return is sometimes pitted against incentive regulation. Rate base rate of return has powerful incentives built in, even though you may not agree with them. Regulation is a means of achieving equity efficiency and other goals. Ms. Beecher believes there will be a co-existence of regulation in markets.

Ms. Beecher stated that while all commissions have some commonalities, there are a lot of variations, many commissions evolved from railroad commissions. Commissions can be constitutional, executive, legislative or independent agencies, and their structures reflect different functional responsibilities, and most regulate multiple sectors and have a professional staff. Some commissions have gone through reorganizations several times. There are significant variations in who gets regulated, what aspect of services gets regulated, and how to do it. All three of those dimensions provide choices. Ms. Beecher has increasingly seen innovative methods to address these three aspects of regulation. Commission jurisdiction is frequently shared with the federal government.

Ms. Beecher's presentation included what commissions have traditionally done and reminded the Task Force that commissions do a lot more than just set rates. It is very important that commissions control market entry, conduct audits, and resolve consumer complaints. In the age of deregulation, commissions have been given the additional responsibilities of establishing performance standards and rules and overseeing the markets and watching for potential abuses of market power. Many commissions have communicated that their workloads have increased because of federal policies. The commissions operate somewhat like courts, and the commissioners are like judges by the fact they review facts, apply the law, and make decisions. Sometimes, a commission will act like a bureaucracy because it implements policy and processes consumer complaints and financial reports. Commissions are also quasi-legislative in that they act as a policy-making agency by making rules. A commission can also become a policymaker by virtue of its decisions.

Ms. Beecher believed there are differing perspectives on the political independence of commissions and these are valid concerns. While some feel commissions need to be more integrated with other interests in the state, others feel commissions should be strictly independent. In the traditional view, regulators are supposed to be independent from other branches of government, political parties, special interest groups, and utility companies. For the most part, a commission should operate with relative independence, but with that independence comes a high degree of accountability. That accountability will be to the Governor, the Legislature, and the courts. Commissions are very responsive to judicial review and pay close attention when their decisions are reviewed and overturned by the courts. Elected commissions are held strictly

accountable by the voters. Ms. Beecher presented other mechanisms of accountability, including the utility companies, consumer advocates, and others who will intervene in cases. There is also external accountability through the media and financial markets such as Wall Street.

Commissions generally have three to five members and turnover can be significant. Terms of office vary with four or five years being typical. Most commissioners are appointed, but some are elected. Some states have statutory qualifications or traditions, i.e. the "labor" seat. If that seat becomes available, the trend would be to fill that seat with someone with a strong labor background. Sometimes there is a party restriction. Right now, commissions are roughly equally divided among republicans, democrats, and independents. Most commissions have to operate with some constraints on communications among commissioners when they are involved in a proceeding. Some have employment restrictions imposed on commissioners when they leave. The law profession is the dominant profession in the regulatory community. In some cases the state legislature will elect the commission, and Ms. Beecher stated there is a geographic pattern. Negative aspects to an elected commission include not being able to specify qualifications, diversity issues, campaign financing, lack of understanding what the commission does, and voter/consumer favoritism on the part of the commissioners. Positive aspects include a broad candidate pool since anyone could run, more transparent and direct accountability to the electorate, high degree of political independence since appointed commissions are quite political. Ms. Beecher's sense is that if you look at all the variables that could affect commission performance, the elected versus appointed variable would probably not have a huge influence. Ms. Beecher believed it comes down to the quality of the individual regulators, and that quality is the more important feature. Ms. Beecher felt politics would come into play regardless of whether it is an appointed or elected process, and all potential commissioners campaign for the job even for an appointed commission seat. Safeguards could include independent review boards, term limits, and other forms of oversight. Ms. Beecher explained the length of service for a commissioner is generally becoming shorter over the years, and this has been challenging given the complexity of the issues.

Ms. Beecher also explained about the critical role staff plays, and staff tenure is much longer than the tenure of commissioners. Staff can be advocates, administrators, and advisors. Staff roles can vary depending upon a particular case. Staff independence can also cause tension if the commission does not necessarily follow a staff recommendation. Ms. Beecher felt it is perfectly acceptable for the staff to put forth their views.

Commissioner Rowe added that in most states the advocacy function, which in Montana lies with the Consumer Counsel, is performed by designated commission advocacy staff. In addition, Montana does not have the amount of staff other states have, and there are not enough staff to have separate staff for each area such as energy and telecommunications.

In addressing the information technology aspect, Ms. Beecher explained many commissions are beginning electronic filings and using websites for central information. Staff helps to address the imbalance that tends to favor utilities. The reality is utilities often have more information and resources to bring to the table than consumer advocates and other parties that may be interested in the regulatory process. In some respects, Ms. Beecher felt staff could be thought of as the "first among equals" because they are adding something that is analytically supported and emphasizes the balancing act perspective.

Ms. Beecher spoke to a strategic planning exercise in Delaware which showed money is a key issue to commission function and structure.

(Tape 3; Side A)

Federal policies are also affecting the workload of commissions, and there are strong opinions as to whether the states' hands are being tied on important fronts. Oligopolies also represent a problem since two or three players do not constitute a terrific competitive market and require monitoring. Resolving market disputes is a whole new role for commissions. Dealing with outcomes associated with restructuring and ongoing transitional issues can also be challenging. Consumer complaints have also been challenging for commissions since there are now more complex complaints.

Ms. Beecher indicated commissions struggle with ongoing education all the time. How you educate the public, Governor, and the Legislature about the functions of a commission and the challenges it faces has been done on an ongoing basis.

Commissioner Rowe interjected and said all of these issues have been a concern to the Montana PSC. Commissioner Rowe felt Montana has done a good job at educating key stakeholders.

In addressing commission performance and whether they can do a more efficient job, Ms. Beecher cited basic measures of efficiency as whether decisions are being issued in a timely manner, and use of electronic filing and information is always more efficient. Processing consumer complaints efficiently and to the satisfaction of the consumer and performance of audits are also important. Outcome measures are the most important and the hardest to measure.

In closing, Ms. Beecher stressed Commissions need to invest in traditional skills of regulation, but then develop new skills. Ms. Beecher thought commissions should be more explicit when evaluating performance and be cautious, but open, to change to see if they get the intended outcome. If the intended outcome is not achieved, an adjustment should be made.

Mr. Drummond was curious about Ms. Beecher's idea that all commissioners campaign for the job, but thought there might be different constituencies for elected and appointed commissioners. Ms. Beecher agreed since in a state with appointed commissioners, utility companies will have more involvement in the process but at a fairly superficial level. Having a Governor that is very consumer orientated or a "consumer slot" on the commission can help address that imbalance.

The question in Mr. Drummond's mind has always been whether an elected commission can give the company a break and recognize there may be times when decisions are made that, in the near term, may be adverse to the interests of consumers but, in the longer term, will better serve consumers.

Ms. Beecher responded a good regulator will take a long-term view and understands the public-interest goals. Ms. Beecher felt there could be political consequences regardless of whether a commission is elected or appointed. At times, all commissioners have to make the hard decision, and some commissioners may be better at communicating why they decided the way they did. Ms. Beecher felt there were checks and balances on both sides. Any good regulator understands financial viability of the utility is important for the long-term provision of safe and reliable service. Therefore, you cannot be a regulator and run a utility into the ground.

Mr. Drummond has observed that in Montana when a company feels it has received a bad decision, it runs to the court or the Legislature resulting in the implementation of law rather than a policy, and this absolutely goes to the detriment of consumers.

Commissioner Rowe added there are states with elected commissions where people who run for the commission are interested in running for Governor. In an appointed commission, you typically see the Governor being blamed for rate increases. Campaigning can be used to educate the public and talk about tradeoffs in an honest way with the public.

Mr. Beaudry commented states with elected commissions feel appointed may be better, and states with appointed commissions feel elected may be better.

Mr. Uda wondered if Michigan State had done a literature review comparing rate of return and cost of capital for utilities across appointed versus elected commission and whether they had reached any conclusions as a result of those studies. Ms. Beecher responded they are primarily an educational body and do not have adequate research staff to perform a study of that nature.

Mr. Uda inquired whether tenure among appointed commissioners was more or less than elected commissioners. Ms. Beecher stated many of the long-term commissioners are elected and maybe you would receive more stability from an elected commissioners. Commissioner Rowe

added on average appointed commissioners serve shorter terms. Term limits also have an affect on the tenure of commissioners.

In addressing the ideal size of a commission, Ms. Beecher felt demographics and workload are important considerations. Ms. Beecher could not predict a correlation between the number of commissioners and the amount of staff used. Commissioner Rowe's experience is that three commissioners versus five commissioners is a question of state political culture and decisions the state wants to make about how it organizes itself. The advantage of three is it is easier to get a majority. Three coupled with term limits, creates a lot of instability since if one person leaves, decisions can get reversed. The advantage of five commissioners is you can comply with open-meeting requirements and still maintain the degree of collegiality. Commissioner Rowe added some states have exceptions to open-meeting requirements for commission deliberations much like state courts. Five is also a good way to organize a commission if it is going to be region-based.

Mr. Uda asked if there had been any studies or analyses indicating how to determine whether a commission has adequate staff and, if it is going to bolster its staff, how it should decide where the increase should be. Ms. Beecher replied there was anecdotal but no systematic evidence. Under staffing shows up when there is an inability to meet deadlines or commissions feel they are under represented in federal issues. Another indication would be diminishing functions that commissions would like to be performing. Some commissions are looking at their funding structures in an attempt to acquire additional support. Some are looking to information technology to save resources, and some commissions are looking at issuing fines as a source of revenue.

Commissioner Rowe stated there needed to be a good mixture of new people coming in and stability. The Montana PSC does have problems with the cases that are not on deadlines and because of limited staff do not get worked. The Montana PSC does not have enough staff to be as active in the mid-west and western energy market design as they would like. More could also be done on the federal level. The advantages to having a small staff are that everyone knows each other, and there is a significant amount of cross-training.

Mr. Swysgood wondered about the rate structures and control of the revenue used to operate offices in other commissions. Ms. Beecher responded the majority of the commissions feel their resources have been constrained. Commissions that are independently funded through their fee structure on utilities have faired better, but are still subject to the same rules and constraints as the general fund agencies, and there has been pretty serious across-the-board pressure placed on commissions. Mr. Swysgood clarified his question asking how many commissions would have a fee structure similar to Montana where there is a budget put forth by the PSC that goes to the Legislature and the Legislature decides what they should get and a rate is

assessed on that amount money and charged off to the utilities that are regulated. Therefore, the Legislature controls what is going to be given to the PSC through the assessment of the rate on the utility. Ms. Beecher replied most commissions have to go through the Legislature or the Governor and did not know of any commission that is completely independent. Ms. Beecher felt the Legislature's involvement as a watch dog was appropriate.

Mr. Swysgood assumed deregulation would also have a driving force on the attitude of commissions and how they react and their authority will be diminished. Ms. Beecher felt commissions have a good ability to react to changes in the deregulation environment. Deregulation has resulted in an increased responsibility for commissions and stated even the best market-based model has its flaws.

Commissioner Rowe added that in telecoms and energy, it tends to be the new entrants who are most interested in an activist and aggressive commission.

Mr. Beaudry pointed out there have been several utility bankruptcies around the country and asked Ms. Beecher if she had any specific advice or warnings to pass on. Ms. Beecher replied she is leaning toward convening a workshop to be lead by the states that have been through a utility bankruptcy to share information. Ms. Beecher observed Montana is approaching NWE's bankruptcy openly and systematically and commented while that is a good approach, it is painful.

Chairman Hines asked about regulatory philosophy and expressed the Task Force's concern with new supply and the ability to secure financing. Chairman Hine asked Ms. Beecher if she saw any trends on the pre-approval concept on a national perspective. Ms. Beecher replied there is rumbling go on and believes a substitute term for "pre-approval" might be needed. Ms. Beecher thought a model could emerge in the end.

Chairman Hines asked Ms. Beecher if she saw a distinction between rate basing from the existing utility versus acquiring a resource from an IPP. Ms. Beecher saw parallels and stated when there is a third party involved, you have to be concerned about the financial viability of the third party. Ms. Beecher suggested that is when ring-fencing and other tools should come into play. A review of the certificated of convenience and necessity should take place regardless. Ms. Beecher was certain there would be additional complexity if there was a contractual relationship with an unregulated third-party supplier.

Chairman Hines asked if Ms. Beecher had seen any movement where the regulators themselves are taking a more active role and assuming more risk on the decision-making process. Ms. Beecher stated there is a certain amount of proactivity now, but it is mixed.

(Tape 3; Side B)

Representative Olson was interested in what would happen if the PSC would take over the default supply obligation and the resources would be built into the rate base and then the PSC contracted for the power for the default supply. Ms. Beecher responded there are some examples of commissions and/or states taking on that function and suggested being cautious since the PSC has the responsibility of looking out for the public interest. Ms. Beecher suggested looking at different institutional models before letting the commissions take on this big step.

Commissioner Rowe indicated the PSC published a proposal to run a bidding process for default supply three or four years ago, and the one thing everyone agreed on was that it was a bad idea.

Chairman Hines invited public comment from the audience, and no additional public testimony was offered. Chairman Hines asked everyone to review the Morgan Joseph contract and send comments to Mr. Bushnell.

Development of Future Work Plan and Meeting Dates


The next scheduled meeting of the Governor's Consumer Energy Protection Task Force will be February 6, 2004. There being no further business to come before the Task Force, the meeting was adjourned at 3:10 p.m.

APPROVED AS TO FORM AND CONTENT:

By: _____
John Hines, Chairman

TRANSCRIPTION CERTIFICATION

I, Cynthia A. Peterson, residing in Helena, Montana, do hereby certify that the foregoing pages constitute a true and accurate transcription, to the best of my ability, of audio cassette Nos. 1-3 of the January 9, 2004, meeting of the Governor's Consumer Energy Protection Task Force.



Cynthia A. Peterson, PLS